

PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298



December 30, 2004

TO PARTIES OF RECORD IN RULEMAKING 04-04-003

On December 21, 2004, Decision 04-12-048 was mailed to the parties without the joint dissent of Commissioners Loretta M. Lynch and Carl Wood. The dissent is now available, and is enclosed herewith.

/s/ Angela K. Minkin

ANGELA K. MINKIN
Chief, Administrative Law Judge

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Enclosure

Dissent of Commissioners Lynch and Wood to D.04-12-048 (Long-Term Procurement)

The Majority Decision states that:

“Fortunately, the California utilities are moving forward in a new hybrid market structure supported in large part by this Commission.”

We are – at best – skeptical that a hybrid market structure will best serve the businesses and families of California. We believe that Californians are best served when utilities that are subject to state jurisdiction own and operate large-scale generation units. Californians are better served when the Public Utilities Commission works with utilities and communities to develop and implement an integrated resource plan. They are better off when our policies pursue aggressive renewable portfolio targets. And both California’s consumers and economy benefit when the Commission enforces that integrated resource plan, instead of merely asking utilities, generators, communities and end users to please adhere to it.

The majority makes a valiant attempt to move toward these goals, and even takes some significant steps forward by improving the ability of future renewable resources to compete with fossil-fueled projects. But in other respects, the decision misses a golden opportunity to solidify California’s integrated resource planning process, removes critical protections against affiliate self-dealing, and relinquishes the Commission’s obligation to review and evaluate utility energy decisions. In so doing it takes at least as many steps backward as it takes forward.

The hybrid energy market approach endorsed by the majority is an apt metaphor for the decision itself. For example, this decision adopts two different long term forecast approaches. On the one hand, it endorses PG&E's approach of including community choice aggregation and non-core departing load estimates, as well as mandated demand response targets, in its demand forecasts. Edison and SDG&E, on the other hand, included no loss of load due to community choice aggregation or non-core departing load, and used actual (not mandated) forecasted demand response targets – and the decision endorses that approach, too. It is true that the decision contains language that directs the utilities to consider Community Choice Aggregation and other, various departing load and demand response policies in the future as the Commission refines them. At the end, however, it is the numbers contained in the utilities' forecasts – adopted by the majority – that will govern the utilities purchases. Those are the only numbers that count. And by adopting one long term plan that includes departing load factors and two that don't, this Commission sends very conflicting signals about the future of programs like Community Choice Aggregation. It establishes hybrid signals about our expectations for demand response. It offers two different views of the world – one for northern California, one for southern California.

The hybrid approach is continued in other sections of the majority decision. The decision anticipates, for example, that the Commission will only review and pre-approve contracts lasting five years or more, but completely removes itself from this process for shorter-term contracts. Thus, the Commission establishes two entirely different processes for ultimately the same result: committing ratepayers to pay for safe, reliable

and clean energy. In the process, this hybrid framework will result in a stronger incentive for the utilities to enter into contracts lasting five years or less. We are not convinced that this is going to get new plants built in California – utility-owned or not.

The utilities appear to be putting some effort into improving their planning processes. Edison reports that it consults with locally-based engineers when developing load forecasts. SDG&E talks about its active participation in regional planning and energy policy forums. The utilities should be praised for these constructive beginnings. However, this is still a modest effort, compared to the locally-based planning we described in our January decision. It is most unfortunate that the majority decision declares that the Commission is satisfied that the utilities are “seriously following” this directive. It would be a mistake for the utilities to interpret this statement to conclude that they have achieved everything we were looking for when we discussed bottom-up, locally-based planning. Because the language in the majority decision is susceptible to this interpretation, it works against our efforts to promote integrated planning.

Of perhaps greater concern is that while the Commission asks for integrated plans, it continues to put roadblocks in front of the utilities, almost as if to ensure that they will never reach the goal. An integrated plan should start with cost-effective energy efficiency and renewables, and fully consider demand response incentives, distributed generation and transmission improvements. Yet, the Commission has ordered that each of these resource options be considered in a separate proceeding, on staggered time schedules.

The proposed decision actively resists an integrated planning approach by ordering that energy efficiency expansion plans be handled in another proceeding, and renewable energy somewhere else. It rebuffs the utilities' concerns that the already-established demand response goals ask for too much too fast, by ordering the utilities to comply with those goals, nonetheless. These demand response targets were set outside of a comprehensive planning process, but the majority decision summarily rejects the utility efforts to consider them in a broader context.

In its comments to the proposed decision, the NRDC raised serious concerns about the gap between the rather generalized plans offered by the utilities and the type of planning that would include the consideration of detailed planning scenarios and the identification of resources best-suited in certain locations. They included specific, more detailed instructions that they suggest imposing on the utilities for the next round of plans. The majority decision briefly mentions the NRDC comments, but does not appear to adopt its constructive suggestions. Again, we are missing an opportunity to advance the planning process in a meaningful way.

The over-all thrust of the proposed decision remains one of encouraging and supporting planning processes that fall short of the mark. Most significantly, the majority decision approves all three of the utilities' long-term plans without explaining why. This is especially troubling because the plans tend to treat demand in the aggregate and talk about the appropriate resource choices in only the broadest generalities. The message seems to be that a utility can submit almost anything it wants, call it a "plan," and it will be approved. This is not good enough.

The mixed approach to the ban on affiliate transactions is similarly puzzling. The majority lifts the ban on long-term affiliate transactions, but maintains it for short-term transactions because, as the decision states, “the market moves too fast and there is too great of a potential for abusive self dealing, with little or no possibility for Commission oversight of these types of transactions”. The majority offers no explanation of why the same self-dealing anticipated in short-term transactions would not also occur in long-term transactions, or which of the conditions that led us to conclude less than a year ago that it ought to be continued, have changed.

Initially, we imposed a temporary moratorium to allow time to develop more comprehensive affiliate transaction rules. Then, we declared that regardless of the nature of those rules, we would ban affiliate transactions entirely. Now, without having developed new rules, the majority has lifted the ban without much new analysis or extensive rationale. This decision calls for “Independent Evaluators” to look over the shoulder of each utility when the right hand negotiates with the left, without nailing down major issues, such as who would select and retain these evaluators. The decision emphasizes that the evaluators should have technically-specific skills rather than being generalists, but does not consider the likelihood that the pool of qualified candidates would be limited to utility industry insiders. If the utility selects and pays the evaluator, how independent would that person or firm be? The decision does not consider that issue. The implication is that the Commission can hand over a difficult regulatory challenge to a utility-chosen consultant and that process will ensure the ratepayers get a fair deal. This is not an exercise of regulatory responsibility – it is wishful thinking.

Further, the majority decision declares that utilities cannot build new generation facilities without first winning a competitive bidding process and that, in order to ensure they don't strategically underbid, they must live with a winning bid as a cost cap. The utility would be allowed to share in any ultimate cost savings. We cannot support this proposal. Just because someone else might offer something that appears to have a lower bid, this proposal unnecessarily eliminates, as a resource option, a carefully-planned and individually-tailored utility generation project that might be best suited to meet the ratepayer's needs. We also think it is a mistake to adopt a cap-and-share approach, because this provides an economic incentive for utilities to pad their bids both to protect themselves from cost overruns and create extra profits through the sharing mechanism.

There are elements of this decision that are uniform and consistent, however. The continued veil of confidentiality drawn over the details of the utilities' procurement processes and commitments is one example. The continuation of the current ERRA trigger that allows for automatic rate increases before a full opportunity to review underlying costs is another. Taken together, these actions result in an abdication of the Commission's legal responsibility to provide for full public review and comment, and Commission oversight of California's energy resources.

There are many other questionable provisions in this decision, but we will only discuss one more – the 20 percent “debt equivalence” adder that would be imposed on any merchant bid. We are not an enthusiastic proponents of developing a strong reliance on merchant power plants, and this adder will make merchant projects appear more expensive. However,

we fear that this adder is a backdoor concession to the utilities' repeated efforts to receive financial rewards for signing merchant contracts.

This issue has repeatedly been redirected to our cost-of-capital proceedings, where the utilities have yet to make a convincing case, yet this order includes statements such as: Debt equivalence "is a real cost that need to be considered when evaluating bids...." The record in this case is not sufficient to support this conclusion, and nowhere else has the Commission concluded that debt equivalence is a real cost – that it in fact will lead or has led to a higher cost of debt.

We suspect that this is so, but it is not good public policy to declare something to be true simply because we have heard it asserted so often. It is even more questionable to reach a Goldilocks-style conclusion that a 30% adder is too great and a 10% adder is too little, so a 20% adder must be just right. The Commission ought to be careful, or it might find itself allowing the utilities to capture an extra 20 cents for every procurement dollar just because an intermediate figure seemed more comfortable. There ought to first be a more careful consideration of relative risks and incentives. Will a utility pursue a new rate-based plant, even if it is cheaper, if a purchased power contract offers a virtually risk-free 20% return? This is a vitally-important question that deserves careful study and a well-reasoned analysis.

These misgivings aside, we compliment ALJ Brown and President Peevey for using this opportunity in this decision to establish a greenhouse gas adder in comparing renewable and fossil fueled generation bids, and to ensure space in all-source solicitations for renewable bids. We

wholeheartedly support these actions and the course they chart for California's continued leadership in clean energy alternatives.

On balance, however, we believe this decision does more to move California back to the deregulation days of AB 1890 than forward in the 21st century. It fails to give the utilities what they need to rebuild California's energy infrastructure. It misses a critical opportunity to meaningfully advance an integrated resource planning approach. It takes plenty of note of previously-adopted requirements in other proceedings like demand response and community choice aggregation, but does nothing to enforce those requirements when it comes to the nitty-gritty of the utilities' long term plans. And it steps away from key regulatory responsibilities.

For these reasons, we dissent.

Dated December 21, 2004, San Francisco, California.

/s/ Loretta M. Lynch

Loretta M. Lynch
Commissioner

/s/ Carl Wood

Carl Wood
Commissioner

CERTIFICATE OF SERVICE

I certify that I have by mail, and by electronic mail to the parties of which an electronic mail address has been provided; this day served a true copy of the original attached joint dissent of Commissioners Lynch and Wood on all parties of record for proceeding R.03-03-004 or their attorneys of record.

Dated December 30, 2004, at San Francisco, California.

/s/ Ernesto Melendez

Ernesto Melendez

N O T I C E

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